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OWNERSHIP AND GOVERNANCE ON THE MORNING AFTER: THE INITIAL RESULTS OF PRIVATIZATION IN MONGOLIA

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SUMMARY
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This paper presents some empirical evidence on the initial effects of a mass privatization program of large enterprises conducted by the Republic of Mongolia. The Mongolian privatization program is instructive because it was implemented very rapidly and systematically and because, as a Soviet satellite state, Mongolia's industrial structure very much resembled that of Russia and the other republics, albeit on a smaller scale. Thus, there may be useful lessons to be learned from Mongolia's experience for other countries embarking on extensive privatization programs, most particularly the republics of Central Asia. Furthermore, because the privatization of the economy is a long-term process that goes beyond the simple transfer of ownership of assets, it is important to assess the links between the design of the program and the achievement of its objectives. Observations of the early results of privatization can shed much light on these links. The authors use data from a survey which they designed and administered to 106 firms in Ulaanbaatar, Mongolia along with other data obtained from the Mongolian Privatization Commission and the Mongolian Stock Exchange. Two related aspects of the impacts of privatization are examined: the pattern of post-privatization enterprise ownership among various groups and changes in the groups' relative influence on enterprise decision-making and governance.

We begin by describing the voucher-based Mongolian privatization program. Characteristics of the program lead directly to a severe understatement of employee ownership in official government figures. We use survey evidence to provide a revised estimate for the structure of ownership that takes account of employees' ability to purchase additional shares in their own enterprise. We also provide data on the localization of ownership and discuss the implications of this phenomenon for attaining the goals of privatization. Also on the subject of ownership, we generate an analysis of the State's significant role as an owner, post-privatization, and attempt to explain the determinants and implications of the State's ownership decision.

The second theme of the paper addresses the emergence of corporate governance for newly-privatized enterprises. We trace the development of the institutional environment for governance and compare the relevant laws to the outcomes reported in the survey. Finally, we provide survey evidence on the shifts in influence in decision-making within the enterprises resulting from the State's divestiture and the creation of new corporate governance institutions such as boards of directors and shareholders' meetings.

The post-privatization structure of ownership that emerges is far different from that intended by the designers of the privatization scheme and the resulting influence on enterprise governance issues wielded by different interest groups reflects this outcome.

1. Introduction

Privatization is only the opening act of a long drama. The initial transfer of title into private hands sets the stage for numerous subsequent transactions and behavioral adjustments. If successful, these developments will achieve two principal, inter-related, objectives: an ownership structure that encourages the depoliticization of enterprise decisions and the establishment of corporate governance that persuades managers to become more responsive to profits (Phelps et al, 1993).

As the lively debates on the mechanics of privatization attest, the initial results of privatization programs are critical in shaping the character of the process that eventually produces these desired outcomes. The length of this process, the nature of its equilibrium, and the probability that the government will later dilute property rights all depend upon the way in which privatization programs initially change the economy's relationships.

While the significance of the new ownership structure in these initial changes is apparent, the governance structures inherited by the new owners are also of vital importance. Mechanisms of control established during the turmoil of the privatization process could perpetuate themselves for many years. For example, pre-privatization corporate charters can initiate mechanisms that effectively allow insiders to maintain control after outsiders gain a majority of shares.¹

For obvious reasons, evidence is only beginning to accumulate on the effects of post-socialist privatization and the resultant patterns of ownership and governance. This is especially the case for mass privatization in the lesser developed reforming countries. This paper reports on a body of evidence that significantly expands the empirical information on this score. Our results, on one of the fastest and earliest privatizers, Mongolia, reflect data both from official sources and from a survey of privatized enterprises, providing a comprehensive picture of the ownership and governance of enterprises immediately after privatization.

¹. As we have found in Mongolia.

We do not argue that privatization in Mongolia, a very small, isolated, nation, is of intrinsic importance outside that country. Rather, Mongolia is a leading indicator of events elsewhere, as a consequence of its unique political status in the pre-perestroika years. For seventy years, although formally independent, Mongolia was de facto the sixteenth republic of the Soviet Union. Therefore, its circumstances were highly comparable to those of the new nations spawned by the demise of the USSR. But the very fact of de jure independence meant that Mongolia began its reforms before those countries.

Mongolia was also a very fast privatizer. By the end of 1992, more than 80% of the industrial, service, trade, and agricultural sectors had been privatized, measured by both the number of enterprises and the amount of capital stock. In the large enterprise sector, with which we are concerned, over 70% of enterprises and capital stock had passed through the privatization process. This is as fast progress on mass privatization as in any country.

The paper begins with a brief description of the Mongolian privatization program. Section 3 presents evidence on the size and the nature of residual state ownership. Sections 4 and 5 present a picture of the overall structure of post-privatization ownership, a picture that is unusually complete in view of the paucity of accurate data on ownership structure in post-socialist countries.² Section 6 examines the structure of corporate governance in the post-privatization environment, particularly focusing on the relative influence of different types of owners. Our concluding comments in Section 7 summarize this evidence.

² Data on ownership patterns across important groups are surprisingly hard to obtain. Earle and Estrin (1994) present a picture of worker ownership for a sample of the leading major reforming countries, while Pistor and Turkewitz (1994) do the same for residual state ownership. Blasi (1994) presents data based on a sample of Russian enterprises, updating the information summarized in Boycko, Shleifer, and Vishny (1993). The picture that we present is as complete as any that we have found on a single country and certainly contains more detail than is found on any country outside those vanguard reforming countries that are the most common subjects of research efforts.

2. Mongolian Large-Scale Privatization

In the first months of the 1990's, Mongolia was still under the hegemony of the Soviet Union, receiving aid equal to 25% of GDP and conducting 95% of its trade within the CMEA. There had been a small amount of decentralizing reform during the perestroika era, but the private commercial sector still accounted for as little as 2% of national income.

In early 1990, a political revolution led to the country's first free elections. The old Mongolian People's Revolutionary Party (MPRP) won, but formed a coalition government in which new parties were represented. Significantly, the economics portfolio was given to a member of the National Progress Party (NPP), which had been formed by a group of young economists who were convinced that the country needed truly radical reforms to move ahead. In fact, many of the reforms that this group advocated were introduced only haltingly, or were slowed considerably.³ This was not the case with privatization, however, where progress kept remarkably close to a very ambitious timetable.

Until the formation of the new government in September 1990, privatization had not been raised in open political discussion. But, the economists in the NPP were quickly able to place their schemes for privatization on the national agenda. Combining various ideas gleaned from Soviet and East European sources, this group proposed a far-reaching and innovative scheme, in which citizens' vouchers would be used to privatize a very large share of state assets. Within three days of being acquainted with the scheme, the Prime Minister accepted it and announced it on national TV, on October 25th, 1990. The Central Committee of the MPRP passively condoned the plan.

In January 1991, the government established the Privatization Commission, whose staff would have considerable decision-making power, and the Stock Exchange, which performed a key role in the smooth privatization of large enterprises. The basic components of the original program made their way into the

³. No doubt the size of the exogenous economic shock at the beginning of the reforms was a major factor in causing delay on some reforms. See Boone (1994) for evidence on this shock and for discussion of stabilization. See Murrell, Dunn, and Korsun (1995) for the development of price liberalization.

law passed in May 1991. Privatization would be comprehensive and fast. "Small privatization" would encompass small enterprises, mostly in the trade and service sectors, livestock, and eventually housing. "Large privatization" would focus on all large enterprises, including state and cooperative farms. Subsequent to the design of the program, politics intervened by separating agriculture from the two other privatization processes, leading to three distinct programs.

Every citizen received a set of ten vouchers, three tradeable ones dedicated to small privatization, and seven non-tradeable vouchers, for the large. All citizens were entitled to use their vouchers in the non-agricultural portion of large privatization, but in practice, farmers used their vouchers in the closed process of farm privatization. Here, we focus on the non-agricultural portion of large privatization, which was aimed at over 400 enterprises in industry, transportation, and distribution.

On the supply side, large privatization was highly centralized. The Privatization Commission staff ordered enterprises to prepare plans, to be reviewed by the Commission's experts. There was little discretion in the preparation of plans and no discretion in the method of privatization--every enterprise would be sold for vouchers on the stock exchange. The prime consequence of these plans was to establish the number of shares to be sold on the stock exchange, each share corresponding to 100 tugriks of net assets valued at historical cost.⁴ Since the voucher price of shares would be determined in a market, the only significance of this valuation arose from the fact that employees were allowed to use their vouchers to buy shares at the initial offering price. In the end, as we discuss in detail in Section 4, because the average market price was below the initial price, this concession to employees was unimportant.

Each enterprise was corporatized shortly after the approval of its privatization plan. At that time, control shifted into the hands of the General Director, the workers, and the Privatization Commission, as

⁴. The tugrik is the local currency.

putative representative of future shareholders. As Section 6 makes clear, important features of governance mechanisms were established during corporatization.

On the demand side, the process was highly decentralized, with markets determining the allocation of shares among individuals. Enterprises were sold in sequence on the stock exchange for vouchers only, with as many as fifteen firms being sold concurrently.⁵ Over half of the citizens of Mongolia have already participated in this process, channeling their orders through a nationwide network of brokerage houses.⁶ The brokerages also run mutual funds, providing an alternative for citizens unwilling or unable to choose particular enterprises.

3. The Residual State Share

The Mongolian privatization program was as comprehensive as any in the ex-socialist countries. Outside the utility and mining sectors, every enterprise was slated for privatization. But, as in many countries, privatization did not necessarily imply 100% private ownership. In fact, the state retained stakes ranging from 15% to 80% in 41% of the first 300 enterprises to be privatized.⁷ (See column 1 of Table 2.)

This outcome was a compromise between the more conservative elements in the government and the radicals on the staff of the Privatization Commission, who were in control of the privatization process. Guidelines, which cursorily defined the enterprises that were to remain under some degree of state ownership, could be loosely interpreted by the staff and were subject to only perfunctory government review. Given the strategic placement of radical reformers within the privatization process, the extent and breadth of residual state ownership is a puzzle that remains to be solved.

⁵. Secondary trading of shares for cash is due to begin soon.

⁶. The remaining citizens are either keeping their vouchers in reserve for future use or have already used their vouchers in the agricultural privatization.

⁷. Pistor and Turkewitz (1994) show that this is a common phenomenon in the process of privatization.

This section provides insights relevant in solving this puzzle. The following empirical exercise explains variations in the size of the residual state share across Mongolian enterprises. Little received theory is available to guide this exercise and, consequently, the results do not test any specific theory. We simply aim to identify patterns in the data and interpret them.

The results are detailed in Table 1. The dependent variable is the percentage of state ownership in privatized enterprises. As this variable is zero for many firms in our sample, a tobit regression is the natural tool. Because important independent variables are available only from survey evidence, the analysis is applied to the one-third of privatized enterprises included in a survey administered in early 1993, rather than for the population of over 300 privatized firms. This survey was administered to all privatized firms in the capital city, Ulaanbaatar.

With the Privatization Commission deciding on state shares, subject to governmental review, the equation explaining residual state shares should be regarded as a reduced form summarizing an equilibrium between the more conservative forces in the government and the more reformist ones administering privatization. Given the centralized nature of the supply side of privatization, enterprises seemed to have little influence on this process. At least this was the understanding gained from official statements, before conducting this empirical exercise.

The most natural hypothesis is that the pattern of residual state ownership reflects the residue of the socialist idea. That is, the state aims to retain activities that had primacy under socialism, particularly large enterprises in heavy industry. But this hypothesis secures only minimal support. The results for the sector dummies in Table 1 indicate that heavy industry is less attractive to the state than all other sectors, including such poor cousins of socialism as agricultural processing and wholesale trade. The size of enterprise, when judged by the number of employees, has the wrong sign. If size is measured by capital stock, however, there is some support for this residue-of-socialism hypothesis.

But there is another interpretation of the capital stock variable. Enterprises with a large capital stock and low debt would have been most favored in the past by state subsidies. Such enterprises were built in the context of the Soviet-inspired program of industrialization. Therefore, the coefficients on the capital stock and debt variables imply that the government retained holdings in the enterprises that were most favored under the old system -- those enterprises most likely to be vulnerable under the new.

Is there evidence that the state maintains protective ownership in the enterprises likely to be most vulnerable during reforms?⁸ This is certainly one way of interpreting the attractiveness to the state of the agricultural processing and wholesale trade sectors, which were already troubled by the quick entry of new firms.

To further explore this hypothesis, we examined several variables that capture the likely vulnerability of enterprises in the new market environment. First, the volume of state purchase orders in 1990 indicates the degree to which enterprises formerly relied on government purchases.⁹ Second, pre-reform international contacts are evidence of preparation for the new world of an open economy. Third, the profits-per-share variable measures the profitability of an enterprise on the eve of the privatization process. Fourth, a dummy variable for enterprise divestiture captures the vulnerability of an enterprise that has had existing ties broken in the restructuring process.¹⁰

The signs of the coefficients for all these variables are consistent with the hypothesis that the state keeps a share in enterprises most likely to be vulnerable in the new environment. Two coefficients, for state orders and profits per share, are highly significant.

⁸. The fact that residual state ownership is protective follows from the view of privatization as a commitment device, as propounded by Boycko, Shleifer, and Vishny (1994). If government officials know that they are likely to be asked to intervene in the future and they want to put themselves in a position where they can be responsive to this request, then their best strategy is to weaken this commitment device by lessening the private share of ownership.

⁹. Note that this is not a measure of present ties to the state. By 1993, state orders were at vastly smaller levels than in 1990. This is a measure of previous ties to the state.

¹⁰. The results of Lizal, Singer, and Svejnar (1994) for the Czech Republic confirm that performance depreciates when enterprises are broken up.

Description of the formal aspects of the Mongolian privatization process would lead one to assume that variations in the state share do not reflect the preferences of enterprise insiders. The administrative aspects of the program were very centralized. The virtual absence of concessions to workers and managers suggests that the political power of insiders was minimal. But enterprise management could decide whether to cooperate with the privatization commission, a power that they could use to press for their concerns. Hence, one must examine whether there are any discernible effects of enterprise bargaining power in the residual state shares.

Two sets of variables examine this hypothesis. First, our enterprise survey provides measures of how influential were an enterprise's workers and management within the pre-privatization enterprise, relative to government.¹¹ Second, according to privatization officials, administrative delays (in approval of the privatization plan and between plan approval and sale of shares) reflect the power of enterprises to resist central dictate.

The results show that the power of workers and managers within enterprises is negatively related to the size of state ownership after privatization. Moreover, power of resistance, as represented in the approval time and delay variables, is also significant. Both of these results suggest outcomes analogous to those produced by spontaneous privatization, in a setting where the very centralization of the privatization process would lead one to downplay spontaneous forces. These results clearly show the power of insiders in the privatization process, even in a country where those insiders were not able to achieve their goals on the political level.

In summary, the results in Table 1 suggest two important ingredients in the determination of residual state shares. The state retains a share in those enterprises that are most likely to be vulnerable in the future. Enterprises use their bargaining power to keep the state share down. On the assumption that

¹¹ Section 6 provides a fuller discussion of the construction of these variables.

insiders will be more concerned to press their claims when their enterprise is more profitable, these hypotheses work in complementary fashion.

From the viewpoint of future developments, the most significant aspect of these results is their depiction of a partially state-owned sector of the economy that is likely to perform poorly. If privatization is best viewed as a commitment device against future government intervention, then the results of the Mongolian process do not evidence the consistent pursuit of this vision. Presumably, demands for intervention will be less resistible when they emanate from enterprises that are facing bankruptcy. In the case of Mongolia, these are likely to be the enterprises in which the commitment device of private ownership is least strong.

4. Insider Ownership

The conventional view in the transition literature, arising quite early (Kornai, 1992), is that amount of insider ownership after privatization reflects a balancing of two objectives in program design--moving privatization quickly through the political process versus establishing effective post-privatization corporate governance. The common compromise is to gain insiders' political support by mollifying their sense of entitlement through some preferential transfer scheme. Thus, in their extensive survey, Estrin and Earle (1994) show that, with the notable exception of the Czech Republic, employee ownership is widespread. They attribute the extent of employee ownership to political realities.

The expectations of Mongolian employees were certainly no different than those of their erstwhile comrades in the socialist bloc. Opposing the workers' demands, the reformers responsible for the original privatization law saw concessions to insiders as detrimental to the aim of equity and harmful to the efficiency of the privatized enterprises. The urban workforce did pressure parliament for concessions, but their political power was limited and parliament's revision of the radicals' draft law gave only a weak preference to employees. In addition, the program designers were responsible for implementation and

tried to use this power to keep insider ownership low. Twenty percent became an unofficial ceiling for employee ownership in large enterprises.

Parliament's concession to insiders was in allowing them to buy shares before the sale to outsiders. But this concession turned out to be quite small. Employees were allowed to use their own vouchers to purchase shares at the initial price of 100 voucher-tugriks, in a pre-public-offering transaction, conducted as the enterprise was preparing its privatization plan.¹² Since the average voucher price of shares turned out to be 76, this amounted to a concession in only a few enterprises. Had all employees exercised their right of priority purchase, this arrangement would have achieved the objective of limiting employee ownership well below the unofficial 20% target, as column 2 of Table 2 indicates.

Employees faced sequential decisions in using their vouchers. First, they had to decide whether to purchase shares in their own enterprise at the initial price of 100. At this stage, they did not have the benefit of market signals about the value of their own firm, but there was information about general trends in share prices for firms privatized before theirs. Given this initial decision, they could then determine how to invest any remaining vouchers, in the same manner as any other citizen. One of the possibilities, after an extended wait, was to use the remaining vouchers to buy shares in their own enterprise at the market price. Leading reformers campaigned actively, even inside enterprises, in an effort to discourage these insider purchases.

In practice, employees resoundingly rejected the use of preferential rights, acquiring an average of only 4.3% of total enterprise shares in this manner out of the 13.6% of shares available to them. (See column 3, Table 2.) But low participation in a preferential scheme of questionable value does not imply that employees were uninterested in their own enterprises. Quite the contrary, we find employees using their vouchers on the stock exchange to concentrate their ownership in the enterprises that employ them.

¹² Workers were given a second, largely inconsequential preference. Family members were given the right of "time priority", meaning that their bids were serviced first when the sum of bids on the stock exchange for shares in the worker's enterprise at a specific price exceeded the number of shares in the tranche being offered for sale. It appears that the stock exchange conducted its operations in a manner that would minimize the effect of this priority.

The ownership stake of employees extends beyond the shares officially registered in their names, to include shares held by family members.¹³ Our enterprise survey provides evidence on this phenomenon and it is only through surveys that such information can be found, given the importance of family-owned shares in facilitating insider ownership.¹⁴ Respondents (general directors) were asked to provide share ownership figures for employees and their families. These data allow us to generate economy-wide estimates of employee-plus-family large-enterprise ownership of 44.6% (column 4, table 2).¹⁵ This is more than ten times greater than official government statistics have announced and more than twice the unofficial target for the ceiling on employee ownership. This ownership rate is consistent with a family size of 4-5 individuals, reasonable by Mongolian standards for an urban family and fairly low for a rural family. Our estimates further show that managers own about 8.5% of employee shares (3.8% of total shares), with the remainder held by workers (columns 1 and 2 of Table 3).¹⁶

An important dimension of employee purchasing decisions is the degree of independence exercised in making choices. Although each employee's decision was his or her own prerogative, there is some possibility that collective decision-making processes were taking place. The evidence that we have on this point relates to the employees' first decision, on whether to take advantage of preferential buying

¹³ Children were entitled to vouchers.

¹⁴ This observation is of some methodological importance. Given that there was such a wide gulf in Mongolia between official data on employee ownership and that found from surveys, one might question the data on other countries that relies only on official sources. Follow up interviews revealed that the discrepancy between survey data and official data was due to problems in the latter, which reflected only pre-public-offering transactions of employees.

¹⁵ For more than one-third of enterprises, exact data, rather than estimates are employed in deriving the figures in Column 4 of table 2. For these enterprises, employee-plus-family ownership is 39%.

To generate economy-wide estimates, we use features of the administration of the privatization program to develop a simple predictive model, not a behavioral one, that relies primarily on mechanical relationships. For example, a single brokerage house was assigned to each enterprise for the purpose of collecting the vouchers of workers interested in participating in the pre-sale of shares at the nominal issue price. We know from interviews with brokers that the vast majority of employees used the same brokerage house to exchange their family's vouchers in addition to their own. Hence, the shares of an enterprise sold through this primary broker are highly correlated with employees' family holdings and are a powerful variable for predicting the total size of employee holdings. The fit of our predictive equation, which includes a number of other similar variables, is therefore close, as the R^2 of 0.69 attests. Moreover, its predictions seem reasonable in comparison to the survey data. We know from our survey data that employee ownership in Ulaanbaatar firms averages 39%; the model predicts 40% employee ownership for non-sample Ulaanbaatar firms and similar urban firms.

¹⁶ Since the size of share holdings, at this stage, was constrained by the non-tradeability of shares and vouchers, the size of management ownership reflects the share of management in total employment.

rights. We estimate that in 16% of enterprises employees unanimously chose to engage in preferential purchases of shares; in 60% of enterprises, there was zero participation in preferential purchases.¹⁷ Thus, in over 75% of enterprises, employees acted unanimously. The obvious conclusion to be drawn from these data is that some mechanism existed in the majority of enterprises allowing managers and workers to act in concert.

By weighting companies by different measures of size, Tables 2 and 3 provide further evidence of the importance of the different types of owners. For example, as a group, employees, by favoring their own enterprises, seem to have done worse than other investors: they own 29.8% of assets valued at historical cost, but only 21.3% of assets as valued by the stock market (Table 2). Employees seem have also laid claim to a disproportionately high share of total debt (35.8%).

These data on employee ownership provide evidence that is qualitatively different from that emanating from other countries implementing mass privatization. Usually, a large share of employee ownership has been a direct result of political concessions. However, employee ownership in Mongolia does not result from the use of raw political power. Rather, it is the result of individuals, singly or collectively, exercising their freedom to choose among investment options, eschewing the highest monetary return on their vouchers in favor of ownership of their own enterprise. This is evidence that in the poorer reforming countries, insider ownership after mass privatization is likely to be the natural order, independently of any political considerations.

In sum, the post-privatization structure of ownership that emerges is far different from that intended by the designers of the privatization scheme. Two central objectives were to improve enterprise performance through outsider corporate governance and to end the role of that state. The data in Tables 2 and 3 suggest that both objectives are some way from being attained. Outside ownership averages

¹⁷ Differences in the timing of collection of employee data and data on the decisions on preferential purchases mean that we were not able to calculate when participation rates were precisely 100%. We take an estimated rate of over 90% as indicative of unanimity.

35.3% of enterprise shares, while the state retains 20.8%, leaving employees and managers with 44% (Table 2, Columns 1, 4, and 5). With insiders and the state together owning an average share of 65%, the objective of depoliticization is by no means assured.

5. Other Dimensions of Ownership

In Mongolia, the stock exchange created mutual funds within brokerage houses, explicitly for the purpose of allowing investors to avoid difficult investment decisions. However, for a variety of reasons, these state-controlled mutual funds were the poor cousins of the privatization process, given little publicity by the state. Entry into the mutual fund market was not free. Thus, it is not surprising that few investors took advantage of this option and only 2% of shares are currently held by mutual funds (Table 3, Column 3).

There is a further aspect to the structure of ownership to which we must turn. It appears that the process of privatization has led to a localization of ownership. This is evidenced in the data in columns 4 and 5 of Table 3. Column 4 shows the proportion of enterprise shares owned by citizens residing in the locality of the enterprises. To understand the significance of this information, it is important to know that approximately two-thirds of enterprises are in localities with populations of much less than 100,000. Yet, the ownership concentrated within a locality is high, amounting to 57% of total ownership (and 71% of non-state ownership). Just as employees bought their own enterprises, it appears that other citizens bought the enterprises that were most familiar to them--the ones in their locality.

In addition, in many cases, the local government frequently controls the state's residual share. Since the cases of local government control are readily identifiable from official data, we have added local private ownership to the locally-controlled state share to obtain data on the proportion of enterprise ownership that is controlled within the enterprise's locality. Column 5 of Table 3 provides this information, indicating that local control averages 75% across enterprises.

Lastly, we examine whether the data on ownership presents a consistent pattern across the economy. The most pertinent disaggregation is along a political fissure, capturing the political environment under which firms were privatized. Local privatization commissions administered the privatization of nearly half of the enterprises. Outside the capital, Ulaanbaatar, and the two other large cities, these local commissions were much more likely to be under the sway of old-style politicians than were their national or urban counterparts. The tables on ownership therefore disaggregate the data between those enterprises in rural areas privatized by local commissions and those privatized by the more reformist national or urban commissions.

Not surprisingly, this partition shows that many of the previously identified patterns are more pronounced in the “rural/local group” than in the “urban/national” one. Employee ownership is much higher (52.2% vs 40.3%), as is state ownership (27.3% vs. 16.7%). Local private ownership is slightly higher, but the aggregate data in the table obscure the important fact that for 43% of enterprises in the rural/local group over 90% of share purchases were by local citizens, whereas this was the case in only 30% of enterprises in the urban/national grouping.

These last results have contrasting implications for depoliticization and for governance. Concentrated local ownership could facilitate the effective influence of outsiders on corporate governance.¹⁸ In contrast, political pressure on behalf of enterprises is presumably more likely in cases where owners can use existing political mechanisms to channel their efforts. This is made more likely by the localization of ownership. Enterprise owners will find it easy to follow the leadership of local politicians, who find it in their interest to press the case of enterprises at a national level.

6. Governance after Privatization

Even the fastest privatization occupies an extended period in which enterprise governance is in limbo between old and new. In Mongolia, 221 days passed between the announcement of privatization and the

¹⁸ This point is due to Ron McKinnon, who has drawn the analogy with Chinese enterprises.

adoption of a law; enterprises then waited an average of 305 days for approval of their privatization plans, and an average of 224 days between approval and the sale of shares. New owners will have to confront the corporate governance arrangements, both formal and informal, that were established during this period.

The designers of the privatization process paid little attention to governance before privatization. The laws and decrees on privatization were silent on the process of corporatization and pre-privatization governance. By default, the Economic Entities Law (or Company Law) of July 1, 1991 became the governing statute, although nothing in this statute indicated that it was intended for application in the pre-privatization environment. An inappropriate law simply filled a vacuum in policy.

A clause of the Economic Entities Law dictated that in newly formed companies a "constituents assembly" of shareholders should meet to adopt a corporate charter and elect the company's first administration. The corporatized companies were interpreted as being newly formed.¹⁹ These meetings were attended by workers, management, and a staff member of the privatization commission, ostensibly representing the interests of the yet-to-exist outside shareholders. At this juncture, the absence of a corporate governance framework specific to privatization facilitated bargaining between management and workers to establish mechanisms of control over the enterprise.

The status of bodies mediating between shareholders and permanent management provides an example of where such a confused legal and administrative environment may lead. In the framework provided by the Economic Entities Law, a "Control Council" was the only body that could play a role analogous to a Board of Directors.²⁰ Control councils are a curious hybrid between the monitoring units of the old centralized administrative system and a German-type supervisory board, a group of outsiders

¹⁹ Actually, the law specified that these events must take place within 30 days of the last sale date for shares. This last-sale date was interpreted as being when the Privatization Commission created the shares, holding them on behalf of their future owners. This curious interpretation was probably technically inconsistent with the law and certainly inconsistent with its spirit.

²⁰ Later, amendments to Economic Entities Law were passed, on July 5, 1993. Of chief importance was the mandate that companies must have a Board of Directors in the Anglo-American style.

elected by shareholders to monitor the operations of the company.²¹ In fact, given that the control councils were chosen before privatization, management had greatly influenced their composition.

Data on the post-privatization composition of these control councils appear in Table 4. These councils are dominated by insiders, a feature of their composition that is all the more remarkable because the Economic Entities law explicitly excludes employees from membership. Law seems less than effective in a society in which the role of law has been trivial for seventy years.

The second remarkable feature of the data in Table 4 is the presence of government officials. This presence cannot be an effect of ownership, since there are fewer government officials on the control councils of enterprises in which government has an ownership stake than in other enterprises. The perpetuation of such arrangements after privatization raises questions about the speed with which ownership changes will bring about the depoliticization of enterprise affairs.

To assess the overall effects of the ownership patterns, identified in Sections 4 and 5, and the governance arrangements, discussed above, our enterprise survey posed a series of questions designed to examine the influence of various groups on decision-making, both in late 1990 and early 1993. For 1993, the relevant decision-makers were general directors, department heads, worker groups, central government, local government, shareholders, and the control councils.²² The 1990 questions omitted the last two bodies, since they did not exist at that time.

Enterprise general directors were asked to rate on a four-point scale each group's influence over thirteen types of decisions, ranging from narrow management issues in which outsiders would not be expected to intervene (e.g. production decisions) to broader strategic considerations over which shareholders and their representatives might be expected to have some say (e.g. distributing profits,

²¹ The Economic Entities Law shows every sign of being based upon German models, as do many of the corresponding laws in Eastern Europe. See Frydman, Rapaczynski, and Earle (1993). In fact, Hungary seems to have provided the model for the Mongolian law.

²² At this time, no enterprises had Western-style Boards of Directors; the nearest equivalent was the Control Council.

setting major goals). In order to obtain a simple composite summary of these ratings, the answers were converted to a numerical scale and aggregated.²³ The resultant indexes of influence essentially apportion the influence over enterprise decisions between the various groups. Table 5 provides data on the resultant measures, the percentage influence of each group over the major decisions of the enterprise. The decision-making groups are collapsed into four composites that match the ownership categories of most interest.

The first row of Table 5 provides the baseline, the distribution of influence in 1990. The rather high level of influence of management (general directors and department heads) in 1990, while perhaps surprising, is consistent with events leading up to the beginning of economic reforms in 1991. By late 1990, major political changes had taken place. The economy was in disarray, the government was losing control of its ministries, and the ministries were losing control of their enterprises.

By 1993, privatized firms had corporatized, redistributed title to their assets, and set up control councils. Given the fact that Table 5 shows the distribution of a fixed amount of total influence, the presence of new outside interests (control councils and shareholders) almost certainly guarantees that the influence scores for the 1990 groups would decline by 1993. On the surface, the new elements of corporate governance realized significant gains in influence, with concomitant reductions in the influence wielded by two of the three groups existing in 1990. (See rows 2 and 3.)

But, as shown above, the influence of these new elements of corporate governance cannot be equated with the influence of non-governmental outsiders. True outsider influence is much less important than suggested by the figures reported in row 2. To show this, it is necessary to reapportion the influence of the control councils and the shareholders according to the representation of government, outsiders, and

²³ The conversion of ordinal to cardinal data inherently contains some degree of arbitrariness. Interpretation of the results in Table 5 should therefore be undertaken in this light.

insiders in these two groups. Survey data allow us to do this on an enterprise-by-enterprise basis, with the summary data reported in row 4 of Table 5.

The picture of corporate governance that now emerges evidences little outsider influence. Insiders appear the real winners in the changes that occur during and immediately after privatization. This is - especially the case in view of the fact that the 1990 data reflect a high point in decentralization under the old system.²⁴ Surprisingly, the state retains a significant amount of influence over the operations of enterprises.

7. Conclusions

This paper has provided a picture of ownership and governance immediately following a rapid mass privatization program. Here, we simply summarize the most important elements of this picture, leaving readers to draw their own conclusions as to likely future developments. We emphasize that this summary reflects the very earliest stages of the post-privatization environment and is likely to be modified significantly by the dynamic market environment that privatization has established.

First, the state has not extracted itself from enterprise affairs. The state retains partial ownership in a rather large percentage of privatized firms and, in a significant number, the state is the majority shareholder. Even in those instances in which the state has withdrawn from formal ownership, it retains a significant amount of influence over corporate decisions and maintains membership in the institutional bodies intended to assure independent corporate governance.

Second, the firms in which the state has retained an ownership stake are those that will have most difficulty surviving in a market economy. This is partly a consequence of the strategic behavior of enterprises, even though the political power of enterprises was relatively small.

²⁴ It is important to note that these data do not simply represent the perpetuation of previous levels of influence. There were real reallocations of influence within individual firms--the correlation of the 1990 influence of the General Director with that in 1993 was quite low even though the aggregate effect of these reallocations was minimal, as Table 5 shows. Hence, the data in Table 5 really do represent the consequences of rearrangements of corporate governance during reforms.

Third, the extent and pervasiveness of insider ownership is surprising, given the objectives of the designers of the privatization program and the parameters they were able to set for the program. Within enterprises, insiders are dominant, with workers and managers now being as influential as at any stage of Mongolian history. It is crucial to note that this result is not a reflection of political power. Rather it is a reflection of the decisions made by employees in the voucher-based, stock-market-place.

Fourth, as a corollary to the previous facts, non-governmental outsider ownership and influence is small, especially in comparison with the objectives of the privatization program. The ownership data imply a limited governance role for outside shareholders, even under a scenario of concentrated outside shareholding ensuing from secondary trading. Given the characteristics of the Mongolian scheme, these results suggest that the failure to create outsider ownership might be endemic to mass privatization schemes that give employees choices.

Fifth, the mutual funds, the one mechanism facilitating concentration of outsider ownership, have played a negligible role.

Lastly, the localization of ownership in the industrial sector appears to be significant.

These results present a somewhat paradoxical case, given the received wisdom on the trade-offs confronting the strategists of privatization: "...the general rule being that conferring special privileges on corporate insiders makes speedy privatization much easier, but also impedes the institution of corporate governance arrangements required for a rapid implementation of badly needed economic restructuring" (Frydman and Rapaczynski, 1993, p. 44). In Mongolia, rapid privatization was achieved with few concessions to insiders. But despite the virtual absence of concessions, privatization did not result in the dominant outsider ownership and control that was a central objective of the privatization scheme.

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TABLE 1: EXPLAINING THE RESIDUAL STATE SHARE IN MONGOLIAN ENTERPRISES

		Tobit Regression With Percentage State Share as the Dependent Variable	
	Mean Values	Tobit Coefficient	Marginal Effect
Number of Employees	344.609	-0.009 (-0.67)	-0.001
Total Capital Stock, in millions of tugriks	44.509	0.329 (3.90)	0.031
Total Debt, in millions of tugriks	19.609	-0.364 (-1.75)	-0.035
Profits per share, thousands of tugriks	0.048	-493.119 (-2.98)	-46.846
International Contacts: dummy = 1 if firm had contacts with foreign firm in 1990	0.517	-4.821 (-0.63)	-0.458
State orders as a percentage of output in 1991	48.057	0.250 (3.11)	0.024
Divestiture: dummy = 1 if firm was a spin-off from a larger firm	0.310	12.298 (1.22)	1.168
Influence of workers on enterprise decisions in 1990, % scale	15.023	-6.123 (-2.51)	-0.582
Influence of management on enterprise decisions in 1990, %	43.839	-1.052 (-1.73)	-0.100
Date of Approval of Privatization Plan, days after 1/1/91	420.920	-0.171 (-2.91)	-0.016
Delay between plan approval and sale of shares, in days	121.897	-0.099 (-1.71)	-0.009
Sector Dummy: Light Industry	0.276	11.702 (0.70)	1.112
Sector Dummy: Agricultural Processing	0.069	56.724 (3.03)	5.389
Sector Dummy: Construction	0.264	39.812 (3.17)	3.782
Sector Dummy: Transportation	0.092	58.844 (3.68)	5.590
Sector Dummy: Service	0.092	-143.531 (0.00)	-13.635
Sector Dummy: Wholesale Trade	0.034	75.996 (3.56)	7.220
Intercept		187.773 (3.16)	
Dependent Variable: Percentage of shares owned by the state	16.13		

Notes: t-statistics are in parentheses.

The omitted sector dummy is for heavy industry.

The R² between predicted and actual values of the dependent variable is 0.62.

The number of Observations is 87, 36 of which are non-limit observations.

For the definition of the marginal effect, see Maddala (1983, p. 160)

TABLE 2: THE OWNERSHIP STRUCTURE OF MONGOLIAN ENTERPRISES, Part I						
		(1)	(2)	(3)	(4)	(5)
	State	Through Priority Scheme		All Purchases	Shares Bought on Stock Market	
		Maximum Possible Employee Purchases	Actual Employee Purchases	Employees and Families	Outside Share-holders	
Percentage of Shares Owned, Average Across Enterprises						
Rural∩Local	27.30	13.58	2.89	52.16	20.93	
Urban∩National	16.73	13.56	5.16	40.34	43.35	
All	20.77	13.56	4.31	44.58	35.31	
Percentage of Net Worth, Valued at Historical Cost						
Rural∩Local	31.20	12.73	2.93	40.80	28.67	
Urban∩National	18.37	8.47	3.97	27.08	54.66	
All	21.12	9.37	3.76	29.78	49.56	
Percentage of Net Worth, as Valued by the Stock Market						
Rural∩Local	37.64	11.85	3.27	40.59	22.15	
Urban∩National	24.48	8.16	5.58	18.92	56.62	
All	26.04	8.60	5.31	21.32	52.81	
Percentage of Total Enterprise Debt						
Rural∩Local	38.60	13.83	4.34	48.97	12.31	
Urban∩National	16.06	11.31	6.10	32.56	51.41	
All	20.64	11.82	5.74	35.79	43.71	

Urban∩National Grouping: All enterprises located in the three biggest cities and all enterprises privatized by the Central Privatization Commission.

Rural∩Local Grouping: All enterprises located outside the three big cities that were privatized under local privatization commissions.

Sources: Columns (1), (2), and (3) are from data provided by the Government Privatization Commission and Stock Exchange. Column (4) comprises estimates for nearly 300 firms, using data on employee ownership obtained in a survey of 106 enterprises and ancillary information on all three hundred firms provided by the Government Privatization Commission and the Stock Exchange. Column (5) is derived from the data used for (4) and (1). The totals of (1), (4) and (5) deviate slightly from 100 due to small differences in the coverage of samples.

TABLE 3: THE OWNERSHIP STRUCTURE OF MONGOLIAN ENTERPRISES, Part II					
	(1)	(2)	(3)	(4)	(5)
	Workers	Managers	Mutual Funds	Local Private Ownership	Local Control
Percentage of Shares Owned, Average Across Enterprises					
Rural∩Local	47.73	4.44	2.06	57.98	85.31
Urban∪National	36.91	3.44	1.99	55.87	69.46
All Enterprises	40.79	3.80	2.01	56.67	75.43
Percentage of Net Worth, Valued at Historical Cost					
Rural∩Local	37.45	3.36	1.85	50.52	81.80
Urban∪National	25.03	2.05	1.90	47.30	59.51
All Enterprises	27.47	2.30	1.89	47.98	64.15
Percentage of Net Worth, as Valued by the Stock Market					
Rural∩Local	37.20	3.38	1.84	48.69	86.33
Urban∪National	17.45	1.47	1.65	38.06	51.93
All Enterprises	19.63	1.68	1.68	39.33	56.01
Percentage of Total Enterprise Debt					
Rural∩Local	44.84	4.13	2.43	44.40	83.28
Urban∪National	30.29	2.26	1.87	52.23	65.28
All Enterprises	33.16	2.63	1.98	50.68	68.86

Urban∪National Grouping: All enterprises located in Ulaanbaatar, Erdenet, and Darhan and all enterprises privatized by the Central Privatization Commission, irrespective of location.

Rural∩Local Grouping: All enterprises located outside Ulaanbaatar, Erdenet, and Darhan that were privatized under local privatization commissions.

Sources: Columns (1) and (2) are estimates for nearly three hundred firms based on the data on employee ownership obtained in survey of 106 enterprises. Columns (3), (4) (5) are derived directly from data provided by the Mongolian Stock Exchange.

TABLE 4: MEMBERSHIP IN THE CONTROL COUNCILS OF PRIVATIZED MONGOLIAN ENTERPRISES

Figures are averages of the percentage representation of each group in a sample of 106 enterprises in Ulaanbaatar.

	All Firms	Firms with no state ownership	Firms owned in part by the state
NON-MANAGEMENT EMPLOYEES	32.4	24.6	44.4
MANAGEMENT OF ENTERPRISE	16.2	11.7	23.0
NON-GOVERNMENTAL OUTSIDERS	27.0	31.4	20.3
REPRESENTATIVES OF GOVERNMENT	24.3	32.1	12.1

TABLE 5: RELATIVE INFLUENCE ON ENTERPRISE DECISION-MAKING

	Government	Management	Workers	Control Council and Shareholders
Influence in 1990	41.75	45.78	12.77	--
Direct Influence in 1993	18.36	48.62	11.27	21.75
Change from 1990 to 1993	-23.39	+2.84	-1.50	+ 21.75
	Government	Management	Workers	Outsiders
Total influence in 1993 (i.e., adjusted for membership in governance bodies)	22.07	50.89	18.70	8.21
Adjusted Change from 1990 to 1993	-19.68	15.11	15.93	+8.21